

May 2020

Policy Brief

Utilization of Village-Owned Enterprises in Economic Recovery After The Covid-19 Outbreak

KEY MESSAGES

- The rural economy makes a significant contribution to the national economy. At present, the impact of the Covid-19 pandemic is felt more in urban areas. Due to the high mobility of seasonal rural workers commuting between their home villages and cities, however, the impact on the rural economy needs to be anticipated promptly.
- In village territories, micro and small enterprises (MSEs) can be empowered to help the recovery of the national economy, however, MSEs are currently facing a great challenge in terms of funding to develop their business.
- Under the Law on Villages, villages have a strong role and the financing capacity of rural development becomes significant. The Village Fund is one source of financing that will promote rural economic potential through the establishment and investment of capital in Village-Owned Enterprises (*Badan Usaha Milik Desa*: BUMDes). Furthermore, BUMDes can be empowered to support the development of MSEs, particularly in addressing funding and marketing issues they encounter.
- The Covid-19 pandemic has had a significant impact on the pace and dynamics of the economy and the impact has also been felt in rural areas. BUMDes can be beneficial for the government to optimize, sustain and reinforce MSEs.
- In the short term, the government can priorities the establishment of BUMDes engaging in financial business that meet the needs of MSEs run by rural business operators. The government needs to set up a steering committee involving relevant ministries and institutions to define the various requirements for rural economic recovery.

COVID-19 AND RURAL ECONOMY

The Covid-19 pandemic has not only had an adverse impact on health but has also harmed socioeconomic conditions. Over the short term, the impact on health is evidenced by the mortality rate of the pandemic which was 6.83 per cent as of 12 May 2020. The pandemic has also caused a slump in economic activity. In the first quarter of

2020, economic growth contracted by -2.41 per cent for an annual growth rate of only 2.97 per cent (Statistics Indonesia 2020). In these conditions, it is possible that there may be a negative impact on public welfare. Over the medium term, economic growth is projected at approximately -0.4 per cent to 2.3 per cent, significantly below that of 2019 at 5 per cent.

The latest data on employment shows a fall in business capacity—indicated by an increase in layoffs and a declining employment rate. The Indonesia Employment Condition report released in February 2020 shows that, although unemployment fell by an aggregate 0.02 per cent, the employment rate fell in several economic sectors—agriculture, mining, wholesale trading, information and communication, financial services, insurance, and other services (Statistics Indonesia 2020). There is an urgent need to respond to these conditions to avoid a surge in unemployment that may have implications for social instability.

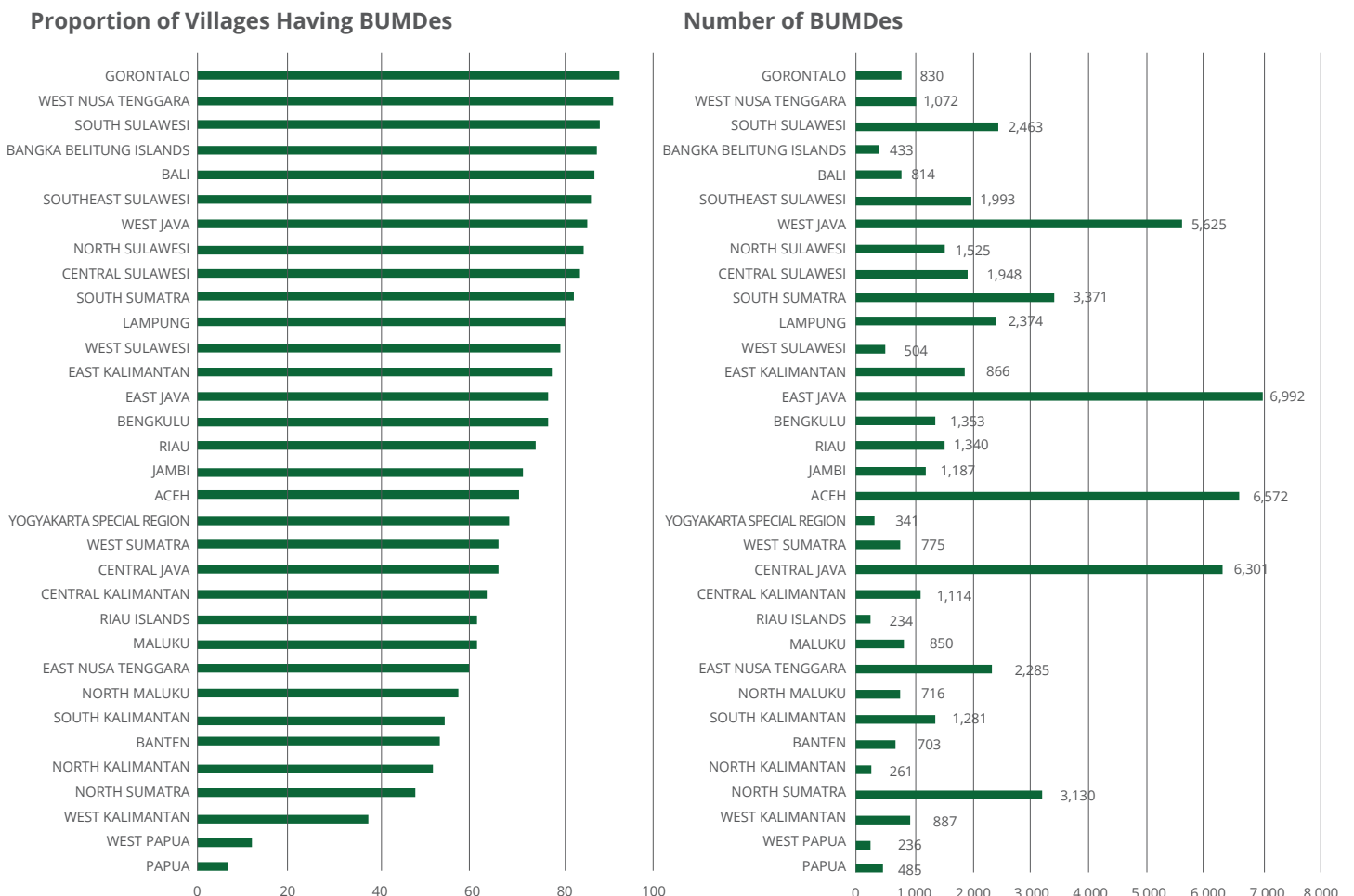
The Covid-19 pandemic has had a negative impact on various aspects of the economy, including the rural economy. The impact of Covid-19 is currently being felt more in urban areas, however, due to the high mobility of seasonal rural workers commuting between rural and urban areas, socioeconomic problems in rural areas need to be anticipated promptly. With the economic and social resources at their disposal, especially the village budget

and village funds, villages are expected to contribute to economic management and recovery from the pandemic.

Basically, villages have assets that can be utilized to maintain and speed up economic recovery. Since the village fund program was released, every village is required to set up one business entity to serve as an economic driver to provide a source of income to pay for various activities. Village-owned business enterprises (*Badan Usaha Milik Desa*: BUMDes) were established pursuant to Article 23 of Law No. 32/2004 on Local Government, specifying that villages may set up a BUMDes in accordance with the village's needs and potential.

Based on data from Village Potential (PODES), 58.28 per cent of villages have a total of 60,911 BUMDes across Indonesia, while the remaining 41.72 per cent do not yet have a BUMDes. Despite the relatively high number of villages with BUMDes, there are many underperforming BUMDes; a problem for the government to deal with.

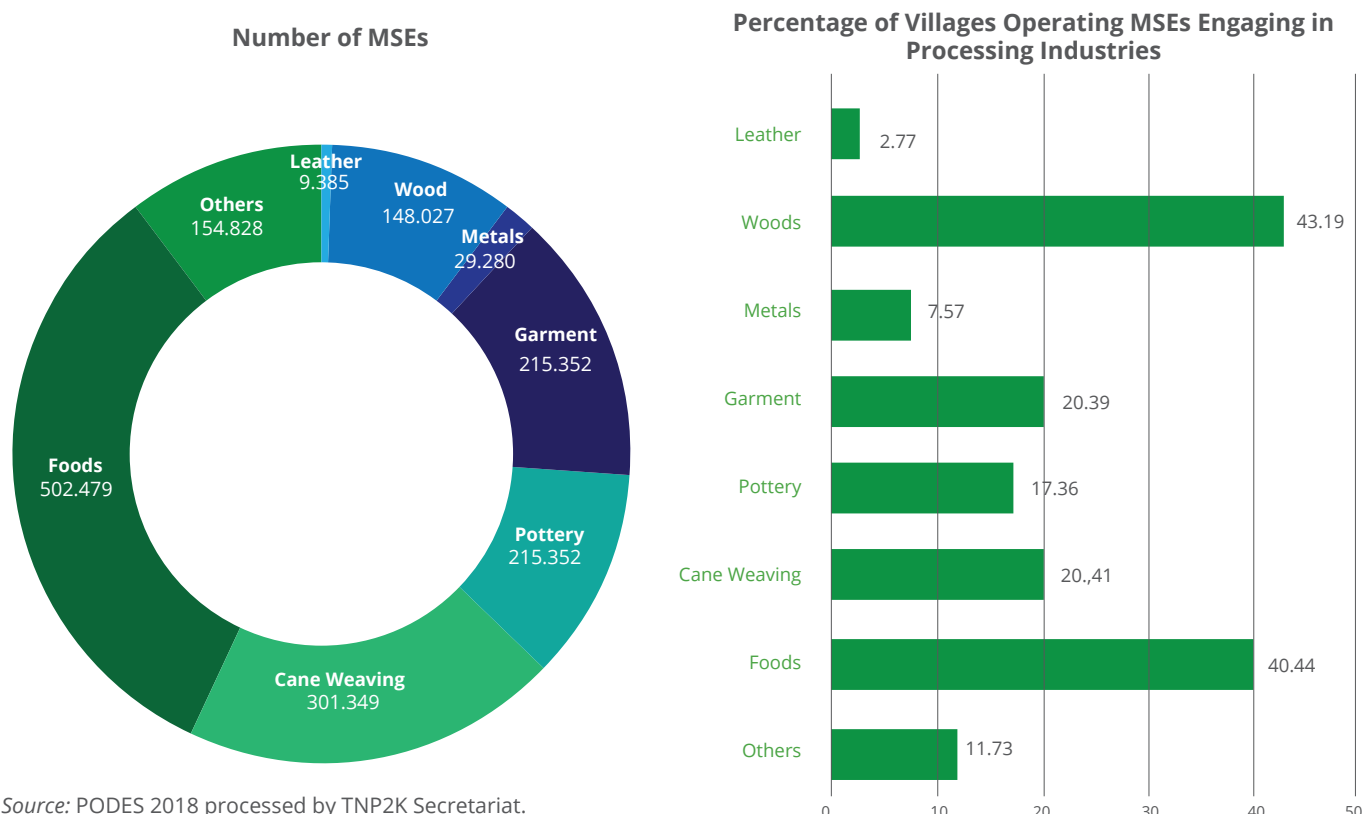
Figure 1. Distribution of BUMDes (2019)



In village areas, there are numerous MSEs, including those in processing industries. Data from PODES 2018 recorded a total of 123,689 active MSEs. This number is greater if MSEs in the non-production and agricultural sectors are added. From an analysis of advanced economic census by Statistics Indonesia, 60.14 per cent of businesses have experienced liquidity and financing difficulties (Statistics Indonesia 2019).

A survey of the agricultural sector also found that only 16.37 per cent of agricultural households gaining access to financing from banks and financial institutions (Statistics Indonesia 2018). With effective management, BUMDes may function as an alternative source of financing to strengthen and maintain the sustainability of MSEs in rural areas.

Figure 2. Distribution of MSEs in Village Areas (2018)



Source: PODES 2018 processed by TNP2K Secretariat.

CONDITION OF MSEs

From the 2016 Advanced Economic Census, there are at least 26 million MSEs employing 59 million people (Statistics Indonesia 2019). Economically, this number of is estimated to contribute 43 per cent of total Gross Domestic Product (GDP). The value-added contribution of MSEs' is not yet comparable with their number, however, they have significant potential and the added value keeps increasing every year.

During 2009-2013 the GDP of MSEs grew from 3.87 per cent to 6.02 per cent (Table 1). This growth outperformed that of medium and large enterprises (MLEs) within the 2011-2013 period that declined from 7.53 to 5.55 per cent. The presence and sustainability of MSEs needs government attention in the response to the Covid-19 pandemic.

Table 1. The Growth of GDP in MSEs and MLEs (in %) (2009-2013)

| Business Scale | 2009 | 2010 | 2011 | 2012 | 2013 |
|------------------|------|------|------|------|------|
| Micro and Small | 3.87 | 5.69 | 6.72 | 6.12 | 6.02 |
| Medium and Large | 5.10 | 6.54 | 7.53 | 6.13 | 5.55 |

Source: Statistics Indonesia 2019.

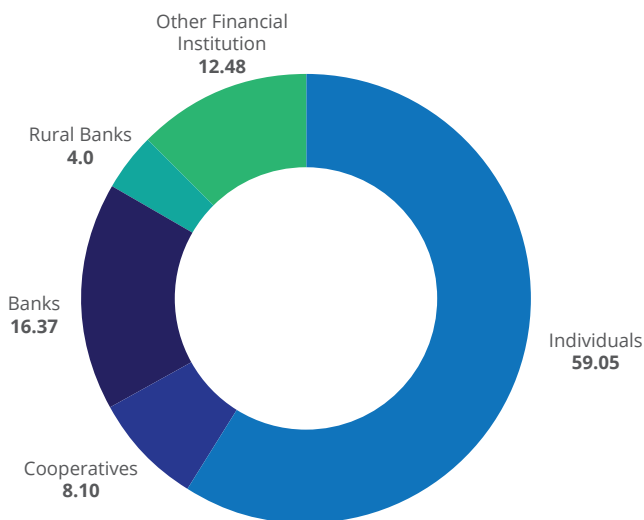
AGRICULTURAL SECTOR

SOUT2017-SPD (Cost Structure of Paddy Cultivation Household Survey 2017) suggests that dryland paddy households still have poor access to bank loans (Statistics Indonesia 2018). Only 16.37 per cent of these households source their interest-bearing loans either partially or entirely from banks (Figure 3). Most households (59.05 per cent) receive interest-bearing loans from individuals to fund their agricultural business activities.

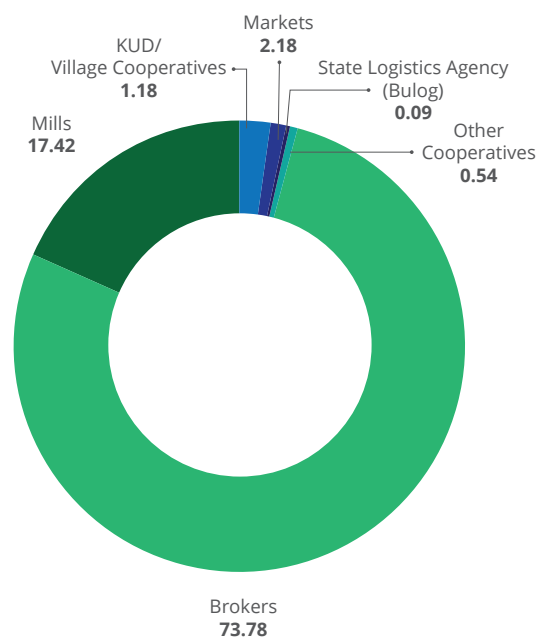
They do not consider banks for loans primarily due to a lack of collateral and complex application procedures. Some 26.77 per cent and 31.48 per cent of households respectively have experienced difficulties due to these two issues. Most households sell their harvest to the brokers (73.78 per cent) and rice mills (17.42 per cent).

Figure 3. Profiles of Agricultural Households In Relation to Access to Market and Financing

Percentage of Dryland Paddy Households by Source of Interest-bearing Loans



Percentage of Dryland Paddy Households by Primary Harvest Point of Sale



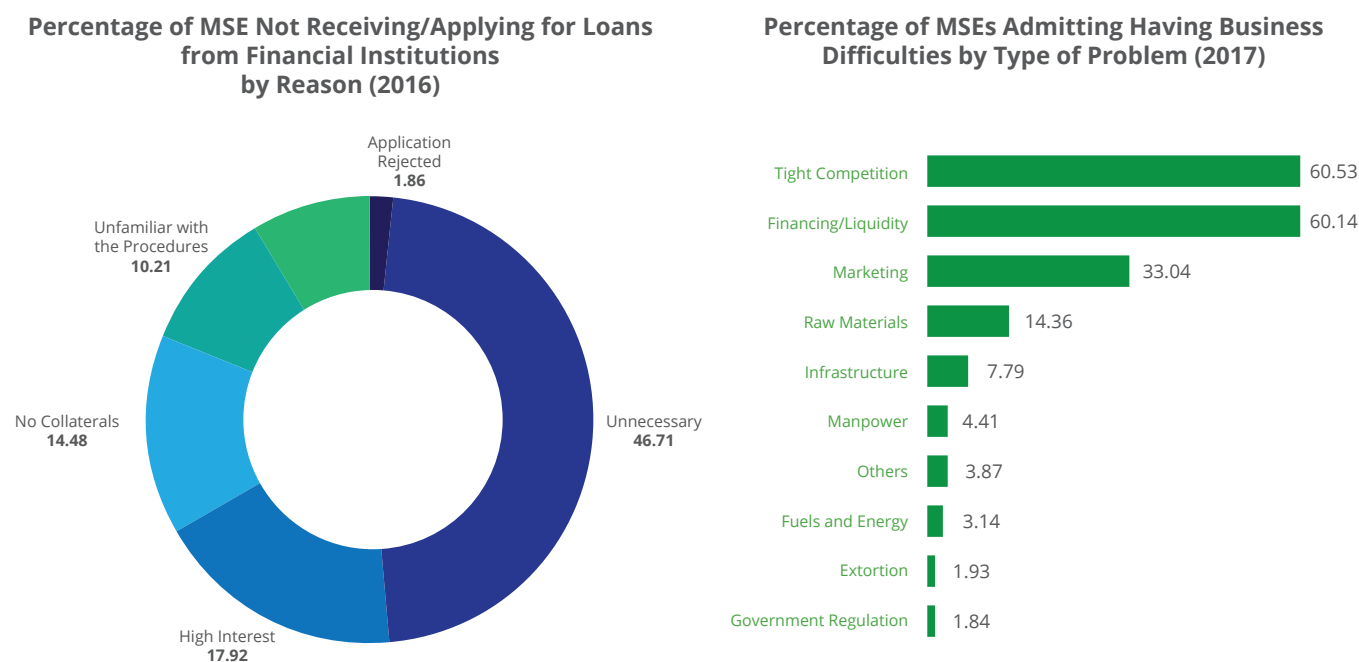
Source: Statistics Indonesia 2018, processed by TNP2K Secretariat.

BUMDes and their business units can provide the solution to economic problems in the agricultural sector in the village. In the short term, BUMDes can play a role in providing relatively more affordable finance for village communities compared to other financing sources, while reducing the practice of taking loans from loan sharks. In the medium term, BUMDes can act as the distributor of agricultural products produced in their region. Furthermore, whenever possible, they can collaborate with other distributors to supply food commodities for central and local government social assistance programs. In the long term, BUMDes have the potential to provide an alternative source of income for agricultural businesses on top of their existing sources of income.

NON-AGRICULTURAL SECTORS

The problems faced in the non-agricultural sectors are nearly identical. The results of the Advanced Economic Census showed that only 11.7 per cent of MSEs have access to finance for their business (Statistics Indonesia 2019). The reasons why business operators who need capital but have not applied for or received credit vary—from high interest, lack of collateral, unfamiliarity with the procedures, complex process, to rejection. Some 47 per cent of MSEs that have not applied for loans from financial institution stated that they did not feel the need to apply for credit (Figure 4). The survey also found that 78 per cent of MSEs admit that they encounter problems in running their business—mainly because of competitors, financing/liquidity problems, and marketing.

Figure 4. Profiles of Non-Agricultural MSEs In Relation to Access to Market and Financing



Source: 2016 Advanced Economic Survey 2018.

Given the problems mentioned above, BUMDes and the development of their business units have the potential to address the issues financing and liquidity in the short term. As for the medium term, BUMDes can be the aggregator that markets the products of the local MSEs. As with the agricultural sector, in the long term, profitable BUMDes can be an alternative source of income for the respective villages in addition to the existing sources, by utilising the potential of local MSEs products.

VILLAGE CAPITAL PARTICIPATION TO BUMDES

BUMDes is governed by the Minister of Villages, Disadvantaged Regions Development, and Transmigration Regulation No. 4/2015 on the Establishment, Administration, Management, and Dissolution of BUMDes. In the regulation, a BUMDes is defined as a business entity whose capital is partially or entirely owned by the village through direct capital participation sourced from separate village wealth. The purpose is to manage assets, services, and other business to the maximum extent possible for the sole purpose of rural community welfare. The establishment of BUMDes is intended to accommodate every economic activity and/or public services managed by villages and/or for cooperation between villages. It is noteworthy that BUMDes activities are profit-based, which management lies on the principles of openness, service, honesty, participation and fairness.

To meet these objectives, BUMDes have to function in several ways. These include being a driver for the village economy, a business institution to produce locally generated revenue, and a facility to accelerate an improvement in rural community welfare. BUMDes are, therefore, expected to be a reliable instrument to engage the rural economy and provide for the community's welfare.

As mentioned in the regulation, there are eight primary objectives of BUMDes. These are: (i) improving the rural economy; (ii) optimising village assets for the benefit of village welfare; (iii) improving community efforts to manage village economic potential; (iv) developing intervillage cooperation or partnerships with third parties; (v) creating market opportunities and networks that support public service needs; (vi) creating jobs; (vii) increasing community welfare through improving public services, growth, and equitable village economy; and (viii) increasing the income of village communities income and locally generated revenue.

BUMDes are strongly connected to rural capital participation, particularly after the enactment of the Village in 2015. The capital of BUMDes is composed of village capital and rural community capital. The source of village capital includes: (i) grants from private parties, community socioeconomic institutions, and/or donor agencies distributed through the village budget; (ii) assistance from central, provincial, and district/municipal

governments distributed through the village budget; (3) business cooperation with the private sector, community socioeconomic institutions, and/or donor agencies that is confirmed as the village's collective wealth and distributed through the village budget; and (iv) village assets granted to the village budget in accordance with the law and regulations on village assets. Village community capital originates from the communal reserve fund and/or community savings in BUMDes in each village.

In relation to supporting access to finance, Article 23 of the Minister of Villages, Disadvantaged Regions Development, and Transmigration Regulation No. 4/2015 states that BUMDes may operate a financial business. These financial businesses are not only to fulfill the needs of micro-scale businesses conducted by village business operators but can provide credit and loans that can be easily accessed by rural communities.

In the age of Covid-19 pandemic, the government has formulated numerous policies to anticipate socioeconomic impacts due to social distancing. As one affirmation measure of handling at the village level, the government has issued the Minister of Villages, Disadvantaged Regions Development, and Transmigration Regulation No. 6/2020 on the deregulation of provisions on the Use of Village Fund of 2020. With this stipulation, the Village Fund can be allocated for the Prevention and Handling of Covid-19, Village Manpower-Intensive program (Padat Karya Tunai Desa - PKTD) and Village Fund

Direct Cash Transfer Program (Bantuan Langsung Tunai Dana Desa - BLT-DD). The government must take similar measures concerning rural capital to BUMDes to maintain the sustainability of MSEs and accelerate economic recovery from the impact of the Covid-19 pandemic. In addition, the government can utilise this momentum to advance the establishment of BUMDes in every village where they are not currently operating.

Nevertheless, in establishing a BUMDes, the need and capability of the community to manage BUMDes must be taken into consideration as not every village has the need for, or can manage a BUMDes. Accelerating the establishment of BUMDes without considering the readiness, needs, and capability of the village will be futile. TNP2K Secretariat observed prior to the pandemic that BUMDes that have the potential to develop and operate sustainably are those BUMDes that can optimise the village potential or engage in public services (such as managing water or markets) or any other business needed by the local community. Strong leadership and the vision of the village head (or in some cases the chief of BUMDes) also substantially determine how BUMDes can thrive.

With proper management, BUMDes can self-sustain villages as well as improve the capability and skills of the rural community. Furthermore, new job opportunities can be created for the village population.

Recommendations

- The government needs to manage utilization of village fund to maintain the sustainability of MSEs and accelerate rural economic recovery. The feasible measures are determining the village fund allocation for rural capital participation, as for BLT-DD and PKTD, and also strengthening the local economy through empowerment.
- BUMDes can partner with MSEs to distribute or market their products. BUMDes may also be a partner for farmers to distribute their agricultural products and supply local foods.
- At present, the government has initiated the allocation of subsidized micro loan funds for MSEs, accessible through banks/micro financiers or fintech. If provided with competent management, BUMDes can facilitate easier access to credit and loans for the rural community while economic conditions remain sluggish.
- The government needs to set up a steering committee involving relevant ministries and institutions—including the Financial Service Authority, Bank Indonesia, the Ministry of Cooperatives and Small and Medium Enterprises, the Ministry of National Development Planning/National Development Planning Agency, the Ministry of Home Affairs, and the Coordinating Ministry for Economic Affairs. This approach is required to define the various requirements that are imperative for rural economic recovery.
- The government can leverage the momentum of Covid-19 pandemic to ensure the establishment of BUMDes by taking into consideration villages potential and needs, and optimize the role and operation of existing BUMDes.

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Support to this publication is provided by the Australian Government through the MAHKOTA Program. The findings, interpretations and conclusions herein do not necessarily reflect the views of the Government of Indonesia or the Government of Australia. You are free to copy, distribute, and transmit this work, for non-commercial purposes.

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